Public Hearing – Retirees' Healthcare Committee
September 13, 2007

OPEB – Bonding for Retirees' Healthcare

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And

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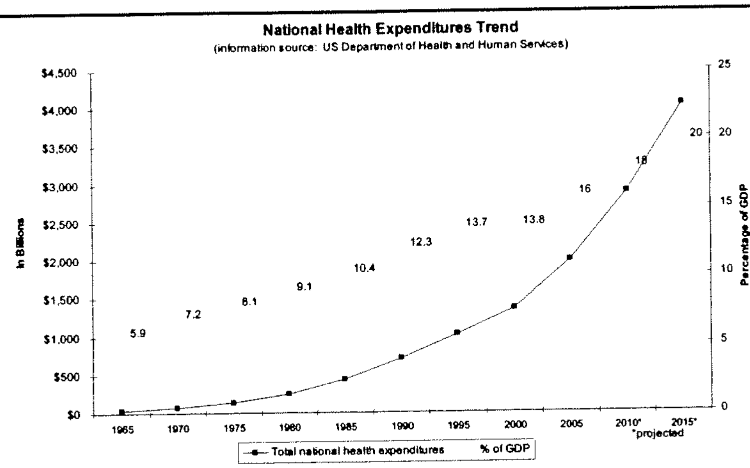
Oakland County Michigan™

Presentation Overview

- National Trends
- Fiscal Impacts – State and Local Governments
- Oakland County:
  - History and Approach.
  - Bonding / Trust Certificates.
- Q & A



Within a 50 year period (1965 – 2015):

- National health expenditures more than double every 10 years.
- Currently $2 trillion is spent annually on healthcare which is expected to double to $4 trillion in another 10 years.
- Consider: these are annual cash payments and do not include promised future payments for benefits already earned (no actuarial data on the national obligation to cover healthcare).

National - Preliminary Estimates

Examples of preliminary unfunded accrued liability (UAL) estimates to date:

- National estimate for state and local governments is **$1.4 trillion**
  (source: Cato Institute Tax & Budget Bulletin No. 40, October 2006, http://www.cato.org/pubs/tbb/tbb_0925-40.pdf)
- Estimate assumes that only 65% of all state and local government employees receive retiree health care benefits
- Compare to annual amount of ***all*** taxes currently collected at state and local level: **$1.1 trillion**
  (source: U.S. Census Bureau, Statistical Abstract of the United States: 2007, http://www.census.gov/prod/2006pubs/07statab/stlocgov.pdf)

Preliminary Estimates – Other Entities

- California – unfunded accrued liability (UAL) - $70 billion.
- Los Angeles Schools – UAL –$5 billion.
- New York City – UAL - $53.5 billion.
- Automobile Companies - Big 3 (GM, Ford, Chrysler Group) – as of 2005 (no tax deduction for pre-funding):
  - Accrued liability $142 billion
  - Assets set aside ($ 29 billion)
  - **Unfunded liability - $113 billion**
- Market value as of Aug. 31, 2007 (outstanding shares times stocks' market value) of: GM ($17.3 billion) and Ford ($16.2 billion), Chrysler ($8 billion), Delphi (say, $3 billion) and Visteon ($.7 billion), the total value is maybe $45.2 billion.
- Toyota – market value is $208 billion – four times the capitalization of the 5 companies above.

State – Retirees' Healthcare Programs

- FY-2006 Pay-as-you-go amount for all entities (including PSERS) - $1.031 billion.
- Pre-funding of the two principal plans (PSERS and SERS) alone would be $1.667 billion and $556.9 million, respectively. Or, $2.224 billion annually for the next 30 years.
- Essentially, pre-funding would require an additional contribution of roughly $1.2 billion, over the pay-as-you-go amount (for the next 30 years).
- UAL reported for two principal retirement plans (September 30, 2005 actuarial reports) – excluding Medicare Part D deducts:
  - SERS - $ 7.665 billion
  - PSERS - 16.700 billion

  $24.365 billion

State – Retirees' Healthcare Program and Other Impacts

- Assumption concerns that lead to the projected UAL and annual required contribution – GASB No. 43 / 45:
  - **Pre-funding / investment rate**. If the State does not pre-fund, the investment rate must be the rate used by the General Fund. A drop from 8% to roughly 4.5% will significantly increase UAL.
  - **Medicare Part D.** Presently, the analysis assumes deductions for Medicare Part D. Cannot assume deductions over 30 years.
  - **Study.** Strongly suggest that State consider determining the validity of assumptions used against actual results for other assumptions.

State – Retirees' Healthcare Program and Other Impacts

- **Reporting implications – failure to pre-fund.** Will require the State to record on the entity-wide financial statements the annual required contributions, serving to increase the deficit already presented in the State's CAFR (presently $1.7 billion deficit at September 30, 2006). Excluding schools – responsibility of school districts, not the State per se.
- **Bonding.** Likely not an option. Conversion of 'soft' liability to a 'hard' liability. Would require covering the difference between the pay-as-you-go amount and the debt service payments for the bonded debt. Closing of plan (would initially increase pre-funding amount).
- **Resolution.** Reduce employer content (co-pays, etc.) in benefit rates and / or reduce number of employees with coverage. Lower coverage (lengthen vesting schedule, type of covered healthcare, personnel covered, exclude employees not yet hired, health savings accounts, etc.).

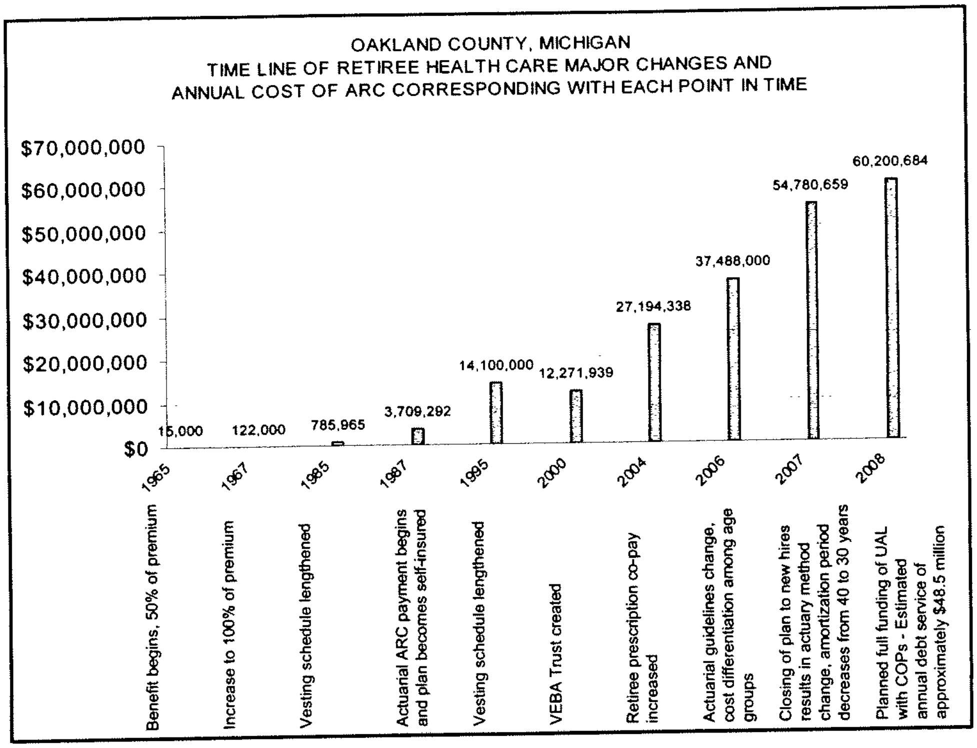
State – Retirees' Healthcare Program and Other Impacts

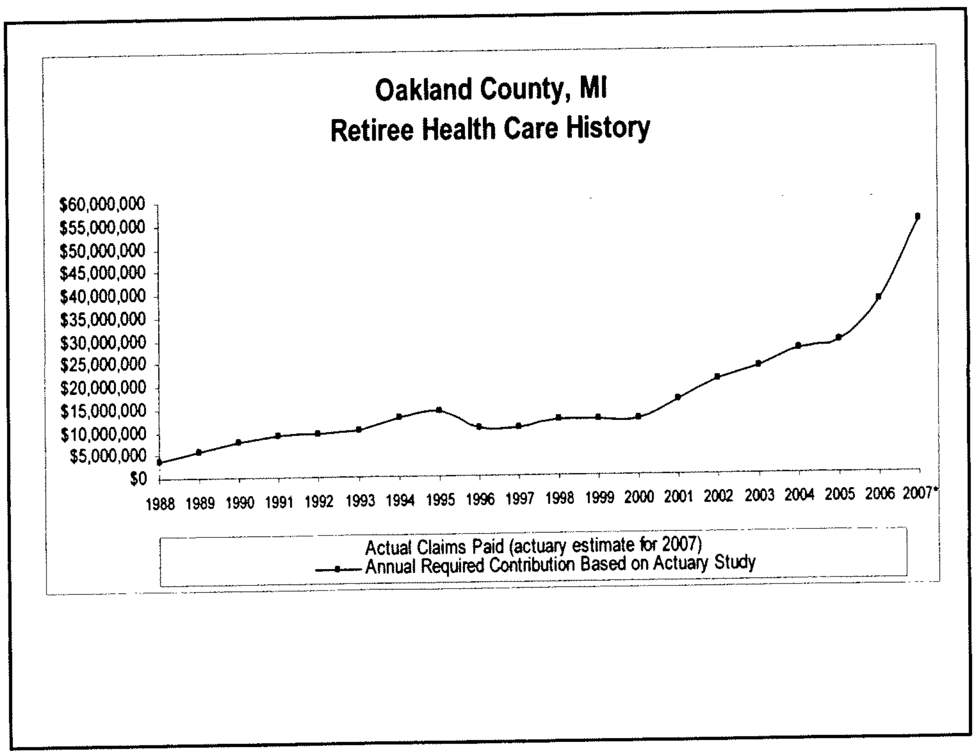
- **Credit implications.** Wall Street knows about sizable obligations and related costs. The concern is <u>not</u> the magnitude of the problem – it is the <u>plan to resolve it</u> that will affect the future bond ratings. Michigan is rated AA- (tied with four other states then comes Louisiana and California at single A).
- **Fiscal health of subordinate governmental units.** State's responsibility for the impact of retirees' healthcare involving cities, villages, townships, counties, and school districts (essentially PSERS).
- **Cost increases v. base foundation allowance.** Along with pension contributions, retirees' healthcare costs will continue to squeeze future school foundation allowances leaving schools in dire fiscal positions.

Preliminary Estimates – Detroit

Detroit:

- Retirees - approx. 20,000). More than active employees (approx. 17,500).
- Estimated UAL: $7.2 billion – in 2004
- Estimated ARC: $584 million – in 2004
- 2004 'pay-as-you-go' basis - $146 million:
  - 20.7% of payroll
  - Number of employees decreasing
- General Fund revenues: $1.4 billion
- If pre-funding started – would need to find $438 million ($584M less $146M) out of $1.4 billion budget, each year for 30 years
- Data is stale – all amounts would be much larger than cited herein if a current actuarial report were available.


OAKLAND COUNTY, MICHIGAN
TIME LINE OF RETIREE HEALTH CARE MAJOR CHANGES AND
ANNUAL COST OF ARC CORRESPONDING WITH EACH POINT IN TIME
$70,000,000
$60,000,000
$50,000,000
$40,000,000
$30,000,000
$20,000,000
$10,000,000
$0
15,000
122,000
785,965
3,709,292
14,100,000
12,271,939
27,194,338
37,488,000
54,780,659
60,200,684
1965
1967
1985
1987
1995
2000
2004
2006
2007
2008
Benefit begins, 50% of premium
Increase to 100% of premium
Vesting schedule lengthened
Actuarial ARC payment begins and plan becomes self-insured
Vesting schedule lengthened
VEBA Trust created
Retiree prescription co-pay increased
Actuarial guidelines change, cost differentiation among age groups
Closing of plan to new hires results in actuary method change, amortization period decreases from 40 to 30 years
Planned full funding of UAL with COPs - Estimated annual debt service of approximately $48.5 million


Oakland County, MI
Retiree Health Care History
$60,000,000
$55,000,000
$50,000,000
$45,000,000
$40,000,000
$35,000,000
$30,000,000
$25,000,000
$20,000,000
$15,000,000
$10,000,000
$5,000,000
$0
1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007*
Actual Claims Paid (actuary estimate for 2007)
Annual Required Contribution Based on Actuary Study

Oakland County Facts

Budget Facts:

- General Fund revenues: $491.3 million
- All Funds revenues: $825.7 million

Number of Persons Eligible for Retirees Health Care:

- Retirees: 1,954
- Active Employees: 3,618

Oakland County Facts

- Pre-funding based on actuarial study began in 1987
- Amounts from most recent actuarial valuation as of September 30, 2006:
  - Total accrued liability: $829.7 million
  - Valuation of assets: $303.1 million (36.6% funded)
  - Unfunded accrued liability: $526.6 million
  - Annual required contribution: $60.2 million

Oakland County Facts

- VEBA – Closed Plan effective December 31, 2005:
  - Changed to retirement health savings account for new employees.
  - $50 per pay period or $1,300 annually.
- Annual required contribution (ARC):
  - FY 2006 ARC = $37.5 million; FY 2007 ARC = $54.8 million ($17.3M increase; 46%). Amount budgeted - $43 million.
  - FY 2008 is $60.2 million.
- Why the large increase in the FY 2007 year?
  - Traditional plan closed to new participants.
  - Change in actuarial methodology from percent of payroll to level dollar payment.
  - Amortization period changed from 40 to 30 years (conform with GASB No. 43 / 45).

Oakland County Facts

- *VEBA TRUST FUND GOOD NEWS*
  - During the past two years, the valuation of the VEBA assets increased 31.7% from $230.5 million as of Sept. 30, 2004 to $303.1 million as of September 30, 2006.
  - Historical investment returns over the past 10 years have been 7.58%, even including the early 21st century downturns.
  - Cost containment efforts have mitigated increase – co-pay / office visits, health savings account.
  - Switching to level dollar payment methodology should minimize future cost increases.
  - Projected decrease in number of traditional plan participants around year 2017.

Actions to Control Future VEBA Funding Requirements

- Issuance of trust certificates to maximize investment earnings potential and minimize future interest rate risk:
  - Will reduce amortization period to 20 years.
  - future budgets more predictable with known annual debt service payments.
  - Conservative estimated NPV savings: $125 million.
  - VEBA will be fully funded.
- Planned buy-out of terminated vested individuals using pension assets / receive waiver of retiree healthcare claims. Program being finalized for Board action.
- Privatization of County functions – MCF for example.
- Eligibility of corrections (jail) officers for binding arbitration – before the Michigan Employment Relations Commission; decision pending.

Actions to Control Future VEBA Funding Requirements

- Wellness Program for employees – very formal approach (backed by $400K appropriation) to improve the employees' health.
- Benefits consultant hired:
  - Audit of primary insurance provider (BC/BS) for medical / prescription.
  - Issue RFP for prescription drug program (competitively bid).
  - Competitively bid Medicare Parts A (hospitalization) and B (professional services) for retirees.
  - Review plan design changes for new hire, active and retiree healthcare package.

Trust Certificates

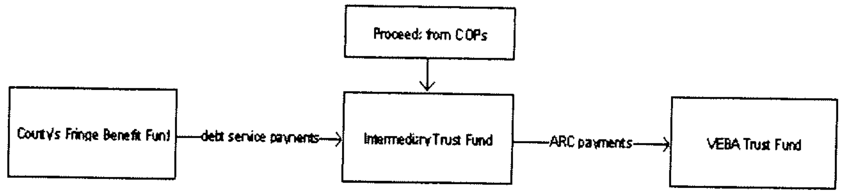
- County attempted to secure a change in Michigan statutes to enable bonds to be issued, but the Governor vetoed the bill citing budgetary burdens on the State.
- Sizing of the trust certificates – in millions:

– Unfunded AAL	$526.6
– 2007 operating short-fall	11.8
– 2008 operating short-fall	14.1
– Issuance costs –	4.5
Total	**$557.0**

Trust Certificates - Funds

- VEBA Fund – will be retained (final resting place of assets).
- Intermediary Fund – will hold the bond proceeds and pay ARC to VEBA.
- County funds will continue to pay the Fringe Benefit (Internal Service) Fund for the debt service component. FBF will cover debt service – a pass-through.

Trust Certificates of Participation - (COP)



Assumptions 552.5

- Principal amount of COP $~~560~~ million (net of issuance costs).
- Anticipated interest rate on debt: 5.5% to 5.75%. Actual interest rate was 6.23%.
- Average rate of return on earnings in trust: 7.5%.
- Annual debt service approximately $48.5 million.
- Annual ARC payment: $60.2 million.

Resource & Contact Information

- Oakland County Insight Article, "Financing Health Care for Retirees," July 2006
  http://www.oakgov.com/exec/assets/docs/insight/retiree_health_07_2006.pdf
- Answers to FAQ's regarding Oakland County's planned use of debt:
  http://www.oakgov.com/exec/insight/retiree_072406.html

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